RB-2001-01 Guidance on the Civil Asset Forfeiture

PURPOSE

This bulletin is intended to alert credit unions to major revisions to the Code of Criminal Procedure Chapter 59, the civil asset forfeit statute, which authorizes and establishes a procedure for state law enforcement to seize and forfeit property related to criminal offenses.

BACKGROUND

The scope of the Code of Criminal Procedure Chapter 59 is broad, and offenses that give rise to seizure and forfeiture generally include any felony offense. Property that is subject to seizure and forfeiture is statutorily referred to as "contraband", and includes any: (i) property used in the commission of or to facilitate the crime; (ii) the proceeds of the crime; and (iii) property derived from or purchased with proceeds of the crime. Not infrequently, a financial institution holds property that may be subject to seizure and

forfeiture by the State.

During the 77th Regular Session, the Texas Legislature amended Chapter 59. Senate Bill 626, which becomes effective on September 1, 2001, expands the protection afforded innocent lienholders and significantly changes the procedures that apply to the seizure of contraband held at financial institutions. To put these changes and their significance in context, we believe it is helpful to briefly discuss some of the more problematic aspects of the prior law before

explaining the recent amendments.

TEXAS LAW FROM 1989 TO PRESENT

Before the enactment of Senate Bill 626, Chapter 59 required a lienholder with a bona-fide security interest in contraband other than real property to prove two things in order to protect that interest from forfeiture: one, that the security interest was acquired prior to or 1 Working together with the Texas Department of Banking, the Department is recommending action in regards to the risk that accounts held at a financial institution, or assets in which a financial institution has a security interest will be seized and forfeited to the State. during the commission of the offense; and two, that at the time the security interest was acquired and perfected, the lienholder did not know or have reason to know of the criminal offense or that it was likely to occur. A credit union that acquired a perfected security interest in contraband after the time the crime was committed lost that security interest no matter how "innocent" or ignorant of the crime the credit union may have

been.

The failure to protect an innocent lienholder that acquired and perfected a security interest after the commission of the crime was not the only problem that Chapter 59 created for credit unions. Chapter 59 also authorized the State to withdraw seized contraband from a credit union immediately upon service of the seizure warrant. Such action, depending upon the amount of the seizure in relation to the credit union's net worth and assets, could jeopardize the credit union's liquidity and potentially precipitate a de facto insolvency and credit union closing. Additionally, Chapter 59 includes no provision for the sharing of information with, or giving notice to, the Department regarding contemplated asset seizures that could adversely affect a credit union.

TEXAS LAW EFFECTIVE SEPTEMBER 1, 2001

The revised law addresses these problems by: 1) recognizing the rights of the innocent lienholder who acquires and perfects its security interest after the commission of the offense but before the seizure of the property; 2) establishing specific procedures for the seizure of accounts and assets at financial institutions; and 3) authorizing, and in some instances requiring, law enforcement's disclosure of information to the Texas Banking Department in those instances when an employee of a financial institution is suspected to

be involved in the crime.

Protection of Security Interests of Bona Fide Lienholders

The revised law continues to recognize the rights of the bona fide lienholder that acquires and perfects its security interest, in what is later determined to be contraband, before or during the commission of a criminal act that gives rise to forfeiture. It does not change what the lienholder must establish in order to keep its interest from being forfeited. Section 59.02(c) still requires the lienholder to establish that, at or before the time of acquiring and perfecting the interest, the lienholder did not know or should not reasonably have known of the act or omission giving rise to the forfeiture, or that it was likely to occur.

Unlike the prior law, however, the revised statute permits the lienholder who acquires and perfects its security interest after the commission of the offense, but before the seizure of the property, to protect that interest. To prevent the afteracquired security interest from being subject to forfeiture, the lienholder must establish that: 1) it was an interest holder for value at the time the interest in the property was acquired; and 2) it was "without reasonable cause to believe

that the property was contraband and did not purposefully avoid learning that the property was contraband." The new law also specifically provides that the rights of lienholders in seized property remain in effect while the forfeiture proceedings are pending as if the property had remained in the lienholder's possession.

Procedures for Seizure of Accounts and Assets at Financial Institutions

The revised law establishes specific procedures to govern the seizure of contraband held at a financial institution when the contraband consists of depository accounts or assets in which the institution has a security interest. A credit union served with a seizure warrant has two options:

- 1. Pay the account or tender the assets at the time the warrant is served; or
- 2. Transfer the account to a segregated, interest-bearing account in the name of the attorney representing the state as trustee, where the account funds or assets must remain until disposed of by final order of the court in the forfeiture proceeding.

If the credit union chooses option (2), the credit union must:

A. freeze and segregate the account or assets immediately upon

service of the seizure warrant; and,

B. provide the peace officer with evidence, certified by a credit union

officer, of the terms and amount of the account or a detailed inventory of the assets.

Except as authorized by the statute, no transaction involving the account or assets, other than the deposit or reinvestment of interest, dividends or similar payments, can occur without court approval. If the credit union fails to release or transfer the account or asset as required by statute, and cannot comply with the court's final forfeiture order certain sanctions apply. The court can order the credit union and its culpable officers, agents and employees to pay actual damages, attorney's fees and court costs. Additionally, the court may find the credit union and those culpable persons in contempt.

The new law establishes a safe harbor from liability for a credit union that complies with its provisions.

Disclosure and Notice Provisions

The revised law authorizes the attorney representing state law enforcement to disclose information to the Banking Commissioner, including confidential information, relating to an actual or contemplated seizure involving a depository account in a financial institution or assets held by a financial institution as security for an obligation owed to the institution.

The state law enforcement attorney must notify the Banking Commissioner before taking any action under Chapter 59 that implicates a potentially culpable financial institution officer or director. The Banking Commissioner is then required to notify the Credit Union Commissioner if the financial institution is a Texas-chartered credit union.

The information disclosed to the Texas Banking Commissioner, and the Department, is confidential, and anyone who knowingly discloses the information except as authorized by the statute, is subject to penalties.

SUGGESTED ACTIONS

What does this mean? What must a credit union do to protect itself against the risk that accounts held at the credit union, or, more importantly, assets in which the credit union

has a security interest, will be seized and forfeited to the State?

- 1. Credit unions should heighten their awareness of their members, especially new relationships and those borrowers that deal in cash and cash equivalent assets. Credit unions should fully understand the nature of a borrower's business, and perform and document background and reference checks for further assurance about the integrity of a borrowing relationship. (A key component of the law's revision places emphasis on the credit union to know its members. Should the credit union find itself in a seizure and forfeiture situation, the extent of that knowledge, and due diligence that is evidenced, will be critical.)
- 2. When necessary, credit unions should adequately document the origin of loan collateral to the fullest extent possible. Supporting documentation could include a bill of sale, purchase money invoice, or a closing settlement statement for real property. Certificates of deposit, equitable securities, and bonds held by third party institutions can present special challenges in determining the nature of their genesis. Prior years' tax returns should receive close review to determine possible asset holdings, sales, and investment capabilities. Additionally, credit union statements may need review to ascertain the extent of cash transactions.
- 3. Understand the use of loan proceeds. Purchase money loans should be well documented with invoices and when possible, credit union checks made payable to the selling party and the borrowing member. Member accounts that receive deposited loan proceeds should be periodically reviewed in order that the intended use of the proceeds can be collaborated with their disposition.
- 4. The Board and management should formulate policies and procedures in the event that the credit union is served

a notice of seizure. At a minimum the policy should address the following:

- A. Who is responsible for coordinating and interfacing with law enforcement officials (includes branch locations);
- B. How will different assets be segregated and who will be responsible for monitoring the segregated accounts (should the credit union chose to retain, and not immediately turn funds over to law enforcement, the amount of funds held by the credit union and verified by the credit union at the time of inquiry, should be the same amount the credit union has provided credit to the member, i.e., collected funds); and,
- C. How and when will the board be notified.

A copy of Senate Bill 626 and the Legislative bill analysis is available for review at http://www.capitol.state.tx.us/BillLookup/BillNumber.aspx.